**COMMONWEALTH OF PUERTO RICO**
**TELECOMMUNICATIONS REGULATORY BOARD**
**OF PUERTO RICO**

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| FCC's Triennial Review Order | ) | Case Number JRT-2003-CCG-0004 |
| | ) | |
| | ) | Re: Review of High Capacity Business |
| | ) | Customer Local Circuit Switching |
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**JOINT REBUTTAL TESTIMONY OF**
**DON J. WOOD AND BRIAN F. PITKIN**
**ON BEHALF OF WORLDNET TELECOMMUNICATIONS, INC.**

**Q. What are your names and business addresses?**

A. My name is Don J. Wood. I am a principal in the firm of Wood &Wood, an economic and financial consulting firm. My business address is 30000 Mill Creek Avenue, Suite 395, Alpharetta, Georgia 30022. My name is Brian F. Pitkin. I am President of InterLink, Inc., with offices located in Alexandria, Virginia. We are the same Mr. Wood and Mr. Pitkin that filed Direct Joint Testimony on Behalf of WorldNet Telecommunications, Inc. ("WorldNet") on November 11, 2003.

**Q. What is the purpose of your testimony?**

A. On November 7, 2003, Mr. Correa and Mr. Reynolds pre-filed Direct Testimony on behalf o Puerto Rico Telephone Company ("PRTC"). The purpose of our testimony is to address the claim by Mr. Reynolds that CLECs face no impairment according to the FCC's economic criteria. Mr. Bogaty and Mr. Walker are concurrently submitting on behalf of WorldNet that addresses the other claims put forth by PRTC relating to operational impairment.

**Q. Is Mr. Reynolds correct that CLECs face no impairment according to the FCC's economic criteria?**

A. No. Mr. Reynolds fails to address many of the issues recognized by the Federal Communications Commission ("FCC") in its Triennial Review Order ("TRO").[1] Mr. Reynolds puts forth what he calls a "back of the envelope" calculation to support his conclusion that there is no impairment for enterprise switching in Puerto Rico. As we explain below, it is unfortunate that he didn't have a larger piece of paper at his disposal:

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[1] *In the Matter of Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capacity*, CC Docket Nos. 01-338, 96-98, and 98-147 (FCC, Rel. August 21, 2003) ("*TRO*").

his analysis is so fundamentally flawed that it is impossible to draw any conclusions from his numbers.

**Q. How is Mr. Reynolds analysis flawed?**

A. Apparently, Mr. Reynolds uses the term "back of the envelope" to mean that he has included virtually every possible revenue source in his analysis but completely omitted most of the major costs. Such an analysis is designed to achieve Mr. Reynolds purposes – to show no impairment – but is far from an independent analysis of the economic viability of self-providing enterprise switching in Puerto Rico. This is particularly troubling since Mr. Reynolds is making the exact same error that the FCC cited in the TRO – that the "studies either failed to adopt the proper framework for determining impairment, were insufficiently granular, or failed to provide sufficient support for the parameters they employed."[2]

Given the FCC's finding in this regard, that studies must be at a sufficiently granular level, include all relevant costs and revenues, and contain support for the assumptions used, Mr. Reynolds' back-of-the-envelope methodology is insufficient. Further, Mr. Reynolds fails to address the FCC's actual language in the TRO:

> 454. Although the record shows no impairment on a national basis, we recognize that a geographically specific analysis could possibly demonstrate that competitive carriers are impaired without access to unbundled incumbent LEC local circuit switching for DS1 enterprise customers in a particular market. As discussed above, while the record shows that cut over cost differentials are eliminated and other operational challenges may be mitigated when competitive carriers use their own switches to serve enterprise customers, the characteristics of enterprise markets do not eliminate all of the cost and operational disadvantages. For example, in a local market with low retail rates, it is possible that difficulties in obtaining collocation space, costs accompanying collocation, high UNE rates for local loops, and backhaul costs could make it uneconomic for competitive LECs to self-deploy switches specifically to serve the enterprise market. In particular, the record suggests that such factors make impairment more likely in rural areas.[3]

**Q. Can you provide examples of how Mr. Reynolds failed to address the very issues cited by the FCC as being relevant to the evaluation of cost disadvantages?**

[2] TRO, ¶ 483.
[3] TRO, ¶ 454 (footnotes omitted).

A. By way of an illustrative, but certainly not comprehensive, list, Mr. Reynolds has made the following errors in his analysis:

- *Mr. Reynolds ignores the costs of providing access.* While Mr. Reynolds does recognize that the $350 of DS-1 loop revenue is offset by a cost of $250 for the DS-1 loop UNE, he makes no such offsetting adjustment for the cost of access.

- *Mr. Reynolds ignores the cost of backhauling traffic to a single switch.* These costs are comprised of either self-provisioned transport SONET rings or leased interoffice facilities and associated electronics (*e.g.*, optical multiplexers, optical patch panels).

- *Mr. Reynolds ignores the cost of collocation equipment.* Again, Mr. Reynolds recognizes only the monthly recurring rate paid to PRTC for collocation and pays no attention to the significant costs of the equipment in a collocation cage. This equipment includes not only the facility termination and multiplexing equipment, but also the costs of the cross connect panels, test equipment, power equipment, and associated frames.

- *Mr. Reynolds ignores the non-recurring costs.* Significant non-recurring charges apply to transitioning a PRTC DS-1 loop over to CLEC facilities, and such a move must be carefully coordinated in order to avoid extended outages of the customer's service. Such coordination is especially important to the businesses that are potential purchasers of this kind of service offering.

- *Mr. Reynolds ignores the non-recurring collocation costs.* Mr. Reynolds' analysis does contemplate the recurring cost of collocation but completely fails to account for the significant up-front capital required to set up collocation arrangements.

- *Mr. Reynolds ignores the additional CLEC internal costs.* The self-provisioning of switching for enterprise customers requires significant additional CLEC investment over and above the cost of the switch. Mr. Reynolds fails to account for any internal CLEC costs associated with self-provisioning switching for enterprise customers.

In other words, Mr. Reynolds has completely ignored the FCC's guidance on the necessity for granular analysis in evaluating impairment:

> All of these studies, including those provided by the BOCs, strongly support the need for a more granular analysis of impairment. We have insufficient evidence in the record, however, to conduct this granular analysis. Such an analysis would require complete information about UNE rates, retail rates, other revenue opportunities, wire center sizes, equipment costs, and other overhead and marketing costs. While some of this information was submitted to us, or is available to us from other sources, the available data do not sufficiently facilitate a granular inquiry into precisely where entry is economic.[4]

[4] TRO, ¶ 485.

**Q. The above errors discuss many significant omissions in Mr. Reynolds analysis. Are there other errors in his analysis?**

A. Yes. Mr. Reynolds significantly overstated access revenues. Notably, Mr. Reynolds calculates access revenues as being the single largest revenue source of DS-1 enterprise customers, assuming that $600 of the $950 in revenues will result from access. Specifically, Mr. Reynolds assumes intra-island access rates slightly greater than $0.09 per minute and interstate access rates of approximately $0.045 per minute.[5] Ultimately, Mr. Reynolds arrives at an average access rate of $0.06 per minute.

First, we understand that these access rates are greatly inflated. The Board has adopted intra-island access rates of approximately $0.01 per minute, a small fraction of the rate assumed by Mr. Reynolds. Second, the access revenues should not be considered in this analysis because access rates should equal the cost of providing access. In fact, the Board's K-2 decision is intended to do just that – bring access rates to costs. Thus, the inclusion of access margins would require one of two possibilities: (1) the access rates exceed the cost of providing access, in which case PRTC's access rates are too high and the Board should reduce them to PRTC's forward-looking costs or (2) PRTC anticipates that competitors can provide access at a lower cost than PRTC, in which case the access rates should be reduced to reflect efficient forward-looking costs. Either way, the only correct assumption regarding access margins in evaluating the economic viability of DS-1 enterprise customers is to assume that access revenues and access costs offset one another.

Further, Mr. Reynolds certainly cannot be claiming that all DS-1 enterprise customers use switched services. The fact is that the vast number of DS-1 lines are non-switched lines used for data services, not voice services. Thus, the absolute number of DS-1 lines used to provide voice services in Puerto Rico is only a portion of the total DS-1 demand. Finally, Mr. Reynolds has provided no support for his assumption that 10,000 minutes per DS-1 would generate access revenues (*i.e.*, non-local minutes).

**Q. Did Mr. Reynolds make other errors?**

A. Yes. The envelope Mr. Reynolds used to make his calculations apparently did not have room for some necessary arithmetic. At page 8, he calculates a cost per month that a CLEC would incur to provision and operate a switch. Based on his assumptions, the cost would be $14,583 per month, not the $17,500 per month that Mr. Reynolds reports.

**Q. What recommendation do you have for the Board?**

A. We recommend that the Board ignore Mr. Reynolds' one-sided analysis (an analysis in which he includes, and even overstates, revenues but ignores the vast majority of costs) and recognize that Puerto Rico is exactly the type of market where the FCC contemplates

[5] Reynolds Direct, page 8, fn 26.

impairment for enterprise switching more likely.[6] In short, we urge the Commission to accept the guidance from the FCC and "rebut the national finding of no impairment by undertaking a more granular analysis utilizing the economic and operational criteria."[7] After all, the Board is "uniquely positioned to evaluate local market conditions and determine whether DS1 enterprise customers should be granted access to unbundled incumbent LEC circuit switching."[8]

Clearly, when one eliminates the inflated access margins from Mr. Reynolds' analysis, his oversimplified calculations show a CLEC margin per DS-1 of $100 per line – before including any of the costs (identified above) that Mr. Reynolds completely ignored. Even at $100 per line, this would require almost 200 enterprise customers using DS-1 lines for voice services.[9] Adding in the additional costs described above may even yield a negative return per customer but would most certainly raise the break-even point to requiring thousands of DS-1 switched customers. These numbers prove that it is not economically feasible to self-provision DS-1 switched lines in Puerto Rico.

**Q. Does this conclude your testimony?**

A. Yes, although we reserve the right to amend or supplement our testimony based on new information, including additional discovery and comments raised by other parties.

[6] TRO, ¶ 454.
[7] TRO, ¶ 455.
[8] TRO, ¶ 455.
[9] Notably, this is more DS-1 voice customers than WorldNet has in all of Puerto Rico.